MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 2, 2016/2017

BAC2644 – CORPORATE FINANCE

9th MARCH 2017
9.00 am – 12.00pm
(3 hours)

INSTRUCTIONS TO STUDENT

1. This question paper consists of 5 pages with 4 questions.

2. Attempt **all FOUR** questions. All questions carry equal marks and the distribution of the marks for each question is given.

3. Please write all your answers in the Answer Booklet provided.

QUESTION 1

a) Aydan Co is a company which installs cabinet in the Klang Valley. It plans to extend its business covering the outskirts in the valley and need RM 3,500,000. The sales orders for the next four years are as follows.

Year	Sales orders (units/year)
1	255
2	302
3	465
4	445

The sales of the cabinet depend on the state of the economy and probability of its selection. The selling price and conversion costs depend on the states of the economy.

Economic probability	Probability of Selection	Selling price (RM/unit)	Conversion costs (RM/unit)
Worst	20%	29,000	22,000
Normal	45%	41,000	28,000
Boom	35%	71,000	39,000

The fixed costs on the other hand, depend on production volume.

Production volume (units/year)	200-299	300-399	400-499
Fixed costs (RM'000/year)	4,000	5,000	5,500

Aydan pays corporate tax of 28% per year, with the tax paid in the year it incurred. Depreciation is calculated based on the straight line basis, and company can claim tax allowance depreciation on the cost of investment over the ten years. Aydan used an after tax discount rate of 11%. Calculate the Net Present Value of the planned investment.

(18 marks)

b) Discuss the strength of Net Present Value (NPV) over Internal Rate of Return (IRR).

(7 marks)
(Total:25 marks)
Continued..

QUESTION 2

a) The equity beta of Ayman Co is 0.75 and the company issued 10 million ordinary shares. The market value of each share is RM 8.20. The Company is also financed by 12% bonds with a nominal value of RM 100 per bond, which will be redeemed in seven years at nominal value. The bonds have a total nominal value of RM 15 million. Interest on the bonds has just been paid and the current market value of each bond is RM105.26. The risk free rate of return is 4% per year and the average return on the stock market is 12% per year. The company pay 20% corporate tax.

i) Calculate cost of equity and after tax cost of debt for Ayman.

(10 marks)

ii) Calculate the weighted average cost of capital for Ayman.

(10 marks)

b) i) Explain how a manufacturer who has an ongoing need for silver as a raw material in the production process might use futures to hedge. What does the manufacturer hope to gain?

(3 marks)

ii) Assume the spot rate for the Japanese yen currently is ¥98.48 per $1 and the one-year forward rate is ¥97.62 per $1. A risk-free asset in Japan is currently earning 2.5 percent. If interest rate parity holds, approximately what rate can you earn on a one-year risk-free U.S. security?

(2 marks)

(Total: 25 marks)

Continued..

QUESTION 3

a) Ibrahim is a financial manager for Abrar Sdn. Bhd. Abrar needs a RM100,000 loan for the next 30 days. Abrar has three alternatives available:

Alternative #1: Forgo the discount on its trade credit agreement that offers terms of 2/5 net 35.

Alternative #2: Borrow the money from Bank AB, which has offered to lead the firm RM100,000 for one month at an APR of 9%. The bank will require a (no-interest) compensating balance of 10% of the face-value of the loan and will charge a RM200 loan origination fee, which means that Abrar must borrow even more than the RM100,000 they need.

Alternative #3: Borrow the money from Bank YZ, which has offered to lend the firm RM100,000 for one month at an APR of 12%. The loan has a 1% origination fee.

i) Calculate the effective annual rate for Abrar if they choose alternative #1, alternative #2 and alternative #3.

(6 marks)

ii) Being a financial manager for the company, determine which alternative should Ibrahim choose. Explain the rationales.

(5 marks)

Continued..

b) As part of the expansion plan Jackson intends to change its company capital structure. Jackson expects its Earnings Before Interest and Tax (EBIT) to be RM100,000 every year forever. The firm can borrow at 11 percent. Jackson currently has no debt, and its cost of equity is 18 percent. The tax rate is 31 percent. Jackson will borrow RM61,000 and use the proceeds to repurchase shares.

i) What will the Weighted Average Cost of Capital (WACC) be after recapitalization?

(8 marks)

ii) Assuming now that Jackson has a debt-equity ratio of 1.4. Its WACC is 10 percent, and its cost of debt is 9 percent. The corporate tax rate is revised to 33 percent. What is the firm's unlevered cost of equity capital?

(6 marks)

(Total: 25 marks)

Continued..

QUESTION 4

a) Maryam Manufacturing has earnings per share (EPS) of RM3.00, 5 million shares outstanding, and a share price of RM32. Maryam is considering buying Najwa Industries, which has earnings per share of RM2.50, 2 million shares outstanding, and a share price of RM20. Maryam will pay for Najwa by issuing new shares. There are no expected synergies from the transaction.

i) If Maryam pays no premium to acquire Najwa, what will the earnings per share be after the merger?

(6 marks)

ii) Assume that Maryam pays no premium to acquire Najwa. Calculate Maryam's price-earnings (P/E) ratio for both pre and post-merger.

(6 marks)

b) You work for a leveraged buyout firm and are evaluating a potential buyout of Maju Jaya Holding. Maju Jaya Holding's stock price is RM15 and it has 10 million shares outstanding. You believe that if you buy the company and replace its management, its value will increase by 50%. You are planning on doing a leveraged buyout of Maju Jaya Holding, and will offer RM20 per share for control of the company. Assuming you get 50% control of Maju Jaya Holding, calculate the price of the non-tendered shares.

(6 marks)

c) Consider the following probability distribution of returns for AMM Corporation

Current stock Price	**Stock Price in One Year**	**Return *R***	**Probability *PR***
	RM35	40%	25%
RM25	RM25	0%	50%
	RM20	-20%	25%

i) Determine the expected return for AMM Corporation.

(3 marks)

ii) Estimate the variance and the standard deviation of the return on AMM Corporation.

(4 marks)

(Total: 25 marks)

End of page.